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The Managerial Implications of Positive and Normative Accounting Theories

Pozitif ve Normatif Muhasebe Teorilerinin Yönetimsel Etkileri

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ÖZ

Karar vericiler olarak yöneticilerin muhasebe prosedürleri ile hisse senedi ve tahvil fiyatları gibi muhasebe raporlarını etkileyen araçlar arasındaki ilişkiyi iyi anlamaları gerekmektedir. Bunu yapmak için, yöneticilerin çok sayıda gözlem ve ampirik testlerin kullanıldığı bu tür karmaşık ilişkileri açıklayan muhasebe teorilerini dikkate almaları gerekir. Muhasebe literatüründe öne çıkan iki muhasebe teorisi, pozitif ve normatif muhasebe teorileridir. Bu çalışma, yöneticinin bakış açısından bu iki teori hakkında eleştirel bir inceleme ve değerlendirme sağlamayı amaçlamaktadır. Tartışılan hipotezler arasında Watts ve Zimmerman'ın yanıt verdiği ifadeler ve yönetimsel çıkarımlara dayanan diğer bazı eleştiriler yer almaktadır. Bu makale aynı zamanda, iyi bilinen muhasebe teorisi araştırmacıları tarafından yapılan yönetici sonuçlarıyla ilgili çok yönlü tartışmalara da değinmektedir.

ANAHTAR KELİMELER

Muhasebe Teorileri, Pozitif Muhasebe Teorisi, Negatif Muhasebe Teorisi, Yönetimsel Etkiler

ABSTRACT

Managers as decision makers need to know the relationship between the accounting procedures and the tools that influence the accounting reports such as stock and bond prices. By doing so, managers need to consider accounting theories which provide the such complex relationships by using large numbers of observations and carefully constructed empirical tests. The two leading theories placed in the accounting literature are positive and normative accounting theories. This study seeks to provide a critical examination and assessment about these two theories from manager's point of view. The hypotheses discussed include those to which Watts and Zimmerman responded and as well as several other critiques based on managerial implications. This paper also comprises multifarious discussions that are related to the manager implications, made by the well-known accounting theory researchers.

KEYWORDS

Accounting Theories, Positive Accounting Theory, Negative Accounting Theory, Managerial Implications

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INTRODUCTION

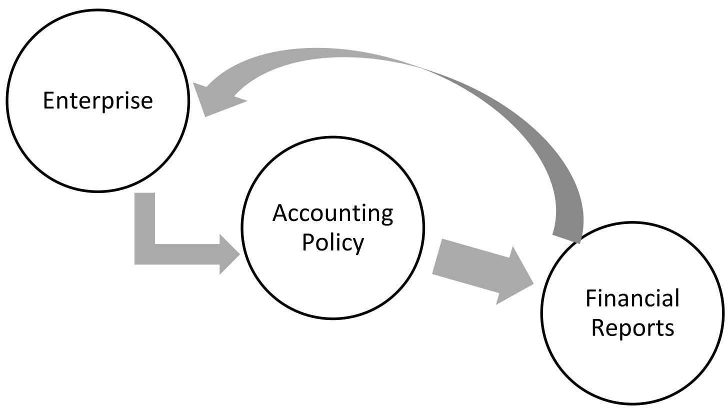
In the last few decades, very important concepts and values have been developed in accounting theory with the contribution of different disciplines that are widely accepted. The accounting discipline needs to harmonise in line with these concepts and values developed due to its traditional role to reliably report to the end users the information they need for decision making (Ertuna, 2017: 8; Kacır, 2018). Without the right theoretical knowledge, it cannot be assured that the practice will produce the right results, because theories arise from the analysis of problems and procedures. Theories are therefore a set of board principles that form the basis of accounting and offer a better understanding and more precises solutions (Osho and Adeniyi, 2018: 40-41). Some leading accounting academics draw attention to the gap between practice and theory and emphasize the need to fill this gap (Richard Baker, 2017: 111; Tucker and Parker, 2013: 133). This is one difficulty with the incomplete basis of accounting theory lies in the practitioners' role in shaping the pattern of what accounting theory is today (Zafeer, 2016: 167).

In order to explain the practices and guide the managers on changing circumstances, accounting theories play an important role as a framework that investigate, understand and develop accounting practices. There is not a single generally accepted theory in accounting literature (Coetsee, 2010: 13). It is, however, possible to mention two main trends that guide accounting research in the literature namely normative accounting theories and positive accounting theories (PAT). The theories created by normative propositions are principally based on what accounting practices should be whereas the theories created with positive propositions have a descriptive and predictive structure dealing with what accounting practices are (Nalçın and Can, 2016: 166-167).

Much of the accounting consequences literature has evolved in the area of positive accounting theory, which has adopted a predictive and explanatory perspective rather than a normative one toward accounting standards (Mangos and Lewis, 1995: 46). PAT seeks to forecast which companies will adopt a precise accounting method and explain which accounting practices will be used under particular circumstances, whereas normative theories provide prescription about how the process of financial accounting should be stipulated (Deegan, 2006: 217). The distinction between these two theories has been made in different ways by the theorists such as Sterling (1990) by demarcating science from non-science and Mattessich (2002) by clarifying some fundamental differences as ethical (positive theory) and non-ethical (normative theory). From management point of view, positive accounting theory explains the actual behaviour whereas normative theory defines optimal behaviour.

Business managers need to decide which specific accounting procedures to employ to work out the numbers given in the reports (Watts and Zimmerman, 1986: 2). In a number of accounting policy selection studies, it is assumed that managers choose the method of accounting to increase their wealth at the cost of another party and some research studies assume that accounting method are chosen for efficiency reason. Accounting policy is a set consisting of various accounting alternatives used in the preparation of financial statements and selected by the entity. As can be seen from the following figure that while accounting policies are a reflection of the entity, financial statements are also a reflection of accounting policies (Gökten, 2013: 126)

Figure 1: The Relation Between Enterprise Accounting Policy



Therefore, applying different accounting policies may lead to different reporting of the same financial events. This may cause the financial situation and the results of the operations of enterprises of the same nature to be very different from each other. Thus, the amounts in the financial statements are a function of accounting policies. Therefore, what factors are effective in the choice of accounting method of managers has been a fundamental question in many accounting studies (Santoso and Sebayang, 2017: 74). Users of financial statements cannot make accurate evaluations about the financial status and operating results of enterprises without knowing the accounting policies (Ulusan and Doğan, 2008: 230).

Nowadays, it is argued that professional accounting standards navigating the today's accounting practices that have been the function of accounting theories in the past, lacking consistent academic progress. With the burden of these standards, the accounting discipline, which is distancing from the theoretical background, does not take into account the efforts to evolve accounting field into a sound academic discipline as much as it should. Managerial dimensions conducted in this study would contribute to develop a critical thinking in the above discussion by allowing managers to assess and identify how theories reflect to the current development in the practice.

The remainder of this paper proceeds as follows. First, a literature review is presented that focuses on the managerial consequences of the two accounting theories. Second, brief information about normative accounting theories and positive accounting theories is given. Third, the narrative discrimination of the two theories are described and summarized. Next, based on the Watts and Zimmerman's hypothesis positive and normative accounting theories from the managerial implications point of view are discussed. These are followed by the discussion and conclusion sections.

1.LITERATURE REVIEW

The introduction of positive research into accounting within the mid-1960s signified to a worldview move. Preceding that time, the most widely recognized scholastic papers were normative. For all intents and purposes, none of the papers in this time period were endeavors to clarify current accounting utilizing numerical modelling or less formal strategies.

Ijiri bases normative theories on deductive methods. First, some goal assumptions are determined and deductive theories that reach accounting processes are considered as normative theories (Ijiri, 1975). In their study (Watts and Zimmerman, 1978, 1986), positive accounting theory has been suggested with empirical studies by explaining company's economic incentives in choosing among accounting methods. Their studies are considered as pioneering articles in developing the PAT which have attracted a great attention with tremendous criticism. A radical study by (Anthony M. Tinker et al. , 1982), they have made studies on ethical normative accounting theory. It was claimed that value-free positive accounting theories have normative origin, thoughts and ideology. In PAT, they often conceal a conservative ideological bias in accounting policy results.

(Sterling, 1990) criticises the positive theory that the positive and real achievements of the theory will never exist and will continue to be zero. Based on their findings, it is to reject the attempt to enter the central stage by radically redefining the fundamental problem of accounting thought in positive accounting theory. Another paper discusses the failures of Watts and Zimmerman's positive theory in mentioning the philosophy of science matters by examining economic-based accounting research (Boland and Gordon, 1992). (Chambers, 1993) in his article claims that the PAT in claiming to give up the prescription, the bases of theory confirm traditional accounting, both active and implied, largely dependent on normative propositions. 'Theory' is overshadowed by oversight, inconsistencies and paradoxes. The methodology pursued 'implicit hope that it will provide a useful positive accounting theory. The aim of (Mangos and Lewis, 1995)'s study is to analyse managers 'choice of accounting practices and to understand the relationship between managers' socio-economic issues. The study acknowledges that the choice of managers of positive researchers provides an inadequate socialized or atomized actor explanation. A possible relationship between corporate social sensitivity and managers' accounting policy choice behaviours can be implied or omitted. (Mattessich, 1995) compares both theories and tries to fill the gap by outlining the methodological basis of a conditional normal accounting theory that recognizes different information objectives (norms), but allows the establishment of empirically verifiable relationships between these objectives and the ways to achieve them. The study discusses past efforts and the current state of this method and future requirements.

(Zimmerman, 2001) in his study, criticize the development of management accountings it has not substantially create a collective body of knowledge. In their article (Lukka and Granlund, 2002) communication structures within the management accounting academy is examined. Their analysis shows that the current communication model between the various research types is not inclined to increase the accumulation of accounting knowledge. According to (Ulusan and Doğan, 2008) in their study of Accounting Policy Choice: Positive Accounting Theory and Economic Determinants – An Empirical Study, they have investigated the economic determinants that may affect company's accounting policy choices of the publicly held companies in Turkey. In order for providing evidence, multiple logistic regression analysis were carried out to analyse Watts and Zimmerman's positive accounting theory in a number of companies listed on the Istanbul Stock Exchange. The analysis showed that the economic determinants do not explain the management's income increasing (decreasing) accounting policy choices.

(Elitas et al. , 2011; Jeanjean and Ramirez, 2009; Sinha, 2008) In their studies, they have come to the conclusion of an ongoing concern about which accounting theory, positive or normative, is better that the best theory is the one integrating the two approaches of the discipline to evolve its full potentials. (Coetsee, 2010; Malmi and Granlund, 2009) discuss the motivation and role of theory in management accounting. They argue that theories in an applied field such as management accounting research should provide useful explanations for the people we work with - managers, organizations and society. (Hans ten Rouwelaar et al. , 2018; Hopwood, 2010; Ittner and Larcker, 2010; Jansen, 2018; Osho and Adeniyi, 2018) discuss their views on the importance of practical research to understand management accounting options and to test economic and non-economic theories. (Kabir, 2011; Kacır, 2018) examines the development of positive accounting theory (PAT) and shows that there are some limitations to the study of accounting in natural sciences. In her thesis (Gökten, 2013) explains the basic findings and methodological assumptions of positive accounting theory; The relationship between the preferences of interest groups to the selection of accounting policies are intended to give Turkey the application aspect. (Ertuna, 2019) argues that the adaptation of accounting theories and practices to this rapid change depends on the developments in two main areas. These areas are the development of accounting standards and the determination of the scope and forms of reporting that respond to needs.

2.DEVELOPMENT OF ACCOUNTING THEORIES

It is possible to define accounting theories as a set of logical principles which provides a better understanding and conceptual framework to evaluate existing practices for the managers, investors, academicians etc. who need a guidance for the development of new procedures and practices (Hendriksen and Breda, 1991: 22). Today, there are several accounting theories in practice that would be better understood if we knew their historical perspective. This would also lead us to find out why accounting is what it is today.

The systematic interest in normative accounting theories around the world emerged in the early 1900s. Normative accounting was first carried out in Germany. After 1915, Heinrich Nicklisch advocated ethical normative studies. From 1919 to 1930 Eugen Schmalenbach was involved in normative accounting. In the 1970s, ethical normative accounting theory began to be seen in England. The pragmatic normative accounting theory is the type of normative accounting theory that was effective in the period that started in the 1950s and continued until the early 1970s.

The introduction of positive accounting theories, one of the basic accounting theories, into the field of accounting dates back to the late 1960s. Prior to this, the accounting literature has a normative structure. It is possible to see that the normative structure is dominated by rules and orders and that there are empirically untested hypotheses. The developments in the fields of economics and finance between the 1950s and 1960s led to the beginning of positive researches in the accounting field and the establishment of the concept of positive theory (Gökten, 2013: 65). The thought behind the paradigm change is that a working theory of existing accounting was not as critical as finding cures for deficiencies.

Table- 1: Historical Developments of Accounting Theories

1929 stock market crash	Poor financial accounting practices including a lack of uniformity across companies
1933 and 1934 securities acts	Task of administering the acts
Common bleif in the 1940s, 1950s and 1960s	Contemporaneous financial accounting was seriously deficient
1950-1970 Normative Accounting Theories	Prescriptions to improve performace have been started to create accounting theory. It is aimed to create general accounting accounting theories.
1970s - contemporary Positive Accounting Theories	Information and communication started to gain importance in the field of accounting. Analysis and interpretation have been important activities of accounting.

The above table illustrates a summary of the historical development of accounting theories. The main purpose of the accounting theory, which should be developed regardless of the period of view, should be to explain which alternative method should be used in which case. In this context, it is possible to divide the periodic differences in the development of accounting as theory development point of view: (1) normative accounting theories and (2) explanatory (positive) accounting theories (Gökten, 2013: 51). While financial economically based PAT was the main factor for normative theory to lose popularity, behavioral science provided the basis for research in the early 1970s.

3.NORMATIVE ACCOUNTING THEORY

Normative accounting theories dealing with what accounting should be, are the theories that determine the rules (Coetsee, 2010: 3; Santoso and Sebayang, 2017: 70). In this respect, the normative theories explain the real word cases not as they are but as they should be. These normative theories are called normative because they are based on the norms (values and beliefs) of the researchers who construct the theory. Normative theories have a principle-based and deductive structure. For example, in these theories, which use the basic assumptions of neo- classical economics, the main objective of the business will be to maximize profit while the main research question is what accounting practices should be in order to achieve this goal (Nalçın and Can, 2016: 166). In other words, the professional experiences that have emerged and matured within the discipline will determine the principles of the discipline and the legitimacy of the theory will be possible by testing these principles. Therefore, studies aiming to provide this legitimacy will take place in the literature as studies based on normative epistemology. Although normative theories give information about how to behave, it is not emphasized why. In other words, there are commands in normative accounting and it is aimed to establish optimum accounting standards. (Gökten, 2013: 63-64) Normative theories are known as prescriptive rather than descriptive theories which outline what ought to be. For example it may prescribe how assets should be valued for financial reporting purposes.

In general normative accounting theory employs two main approaches namely goal assumption and deduction approaches (Inanga and Schneider, 2005: 231). According to the normative accounting theory, it is possible to derive objectives from accounting applications in an inductive way by a theorist who can later on deal with the objectives in order to advise improvements in the present practice (Kabir, 2015: 2). Taking those suggestion into accounts decision makers to use the structure provided to handle the practical issues (Jansen, 2018: 1487). Using such accounting information as market share, customer loyalty and cost of quality to support the management to adapt a new techniques creates an enormous normative literature (Jansen, 2015: 45). Activity based costing is an example based on normative theories where it provides managers tool and techniques to assign indirect costs in a prescriptive way. The assumption behind that if you provide manager a more accurate cost information, it will be embraced (Zimmerman, 2001: 424).

Value based management concept is considered as an illustration of normative theories as it provides number of measures which are suggested managers to increase the shareholders' value (Malmi and Granlund, 2009: 601). Here maximising shareholders value is deduced from the concept of value based management which is a set of assumptions being employed as a tool to support intervention.

The normative nature of financial information has been an important issue in the academic literature for the usefulness of decision-making (Brigitte Eierle and Schultze, 2013: 4). Previous normative accounting research has focused on how information provided by accounting will be useful information that users need (Bourmistrov, 2017: 490). According to early studies in normative theory revealed by American Accounting Association in 1977 , information about a model or criterion to be applied in decision making is extracted and compared with the data required for the application of these decision models from various accounting applications (cited in Kabir, 2015: 2-3).

Some researchers stresses that the decision usefulness aspect of the normative accounting theory has reflected today as the creation of the FASB Conceptual Framework where it was officially adapted. It is possible to say that the Conceptual Framework normativeizes accounting because it is aimed to produce a common language (Richard Baker, 2017: 110). (Watts and Zimmerman, 1986: 4) states that "after the US securities acts accounting theorist became more oriented with prescribing policy recommendation from a normative point of view. Although the effect of normative accounting has decreased since 1970s, it will be possible to talk about the existence of normative accounting in every period as long as accounting standards are effective (Gökten, 2013: 63-64).

Normative theories, where primary concern is recognition and measurement problems, have been engaged in establishing and developing accounting principles in the early twentieth century (Kabir, 2015: 1).

It is seen that the generally accepted classification of normative accounting theories consist of four types. These are (1) historical cost accounting, (2) deprival-value accounting, (3) current cost accounting and (4) exit-price accounting. These theories are about how accounting practices should be. To narrow the issue a little more, these theories focus on how to value the financial statement items. In each theory, by some major accounting theorists, the method by which business assets should be valued is mentioned. In this way, different valuation methods have led to the formation of different types of normative accounting theories. These normative theories generally focus on what needs to be done in accounting when prices increase (excluding historical costs) (Gökten, 2013: 57).

According to the normative accounting theory, regardless of the depreciation method of companies, managers should have the maximum price for the sale of used capital assets. Though, it is predicted by the theory that depreciation method triggers differences in accounting book values, producing managers to depart systematically from this normative description (Jackson et al. , 2010: 757).

One difficulty with the normativist alternative is mentioned by Jones, Romano & Ratnatunga, (1995) that there are an unlimited number of possible functions that accounting might fulfil and given resources are limited we have to choose among them. Different individuals have different functions for accounting: a corporate board member could argue accounting's function is to control managerial action; a financial analyst might argue that it is to provide information to capital markets for investment decisions; a regulatory body might argue its function is to supply it with information so it can regulate and a fourth might argue for some their function.

The researchers' desire for scientific research has gained the power that is supported by the fact that normative theory positions itself as a theory away from practical application. (Jansen, 2018: 1488; Jeanjean and Ramirez, 2009: 122). According to Watts, R. L. (1995 p.300), accounting research is called for business schools because the managers are taught how to make decision (how to develop prescription) by the schools and theory is vital for rational decisions. For instance, the manager trying to decide whether units answering to him should be organized and accounted for as profit or cost centres wants to predict and assess the effects of those alternative organizational and accounting arrangements and choose the one that best meets his objective (e.g., maximizing firm value)".

4.POSITIVE ACCOUNTING THEORY

According to Watts and Zimmerman (1986), positive accounting theory attempts to explain and predict accounting practice. This purpose of positive accounting theory is maintained throughout the literature.

Numerous use expressions such as “as predicted by positive accounting theory”. The primary question addressed by positive accounting theory is “How do accounting standards affect management’s wealth?” (Watts and Zimmerman, 1978: 113).

The issue emphasized by normative accountants is that the main reason behind the change in accounting methods and policies of business managers is to manipulate the market. Afterwards, as stated in the Efficient Markets Hypothesis, it was explained that if the market is effective, business managers cannot manipulate the market by making changes in accounting methods. But there is an unexplained question; if managers are not changing accounting methods and policies to influence stock prices of businesses, what is the main reason behind their changes? In order to answer this question, Watts and Zimmerman developed PAT with the help of the Agency Theory (Gökten, 2013: 125).

After PAT has been included in the literature, accounting research has gained great momentum. Research in this area has generally focused on the relationship between facts and predictions in the future. On the other hand, it deals with the selection of accounting methods and which accounting procedures to follow in reporting the earnings. There must be a reason for which accounting method or procedure to choose according to PAT. (Santoso and Sebayang, 2017: 75-76). The choice of accounting policy due to its effect on the financial statements affects the decisions of the related parties. The question of whether this potential impact will be decisive in the choice of accounting policy has led to the investigation of the reasons underlying the choice of managers' accounting policy (Ulusan and Doğan, 2008: 251). The most important of PAT's contribution to accounting is the reasons behind the choice of alternative accounting methods. In short, the main issue addressed in PAT is that the choice of accounting method is not random and must be examined both for the enterprise and their stakeholders (Gökten, 2013: 129-130).

Research conducted using positive accounting theory as a paradigm gives the impression that positive accounting theory can be expressed as “Management acts in its own best (self- serving) interests.” Research conducted under this view of positive accounting theory has contributed to the literature by revealing previously unknown empirical regularities, such as the association between leverage and accounting method choice (Watts and Zimmerman, 1990: 150). It is important to note that the relationship between accounting and different disciplines, such as behavioural sciences, synthesized into a form that is practically applicable. Therefore, positive accounting studies will necessarily enter the fields of study of other disciplines and create new information production areas and increase the scientific quality of accounting (Nalçın and Can, 2016: 167).

In order to explain accounting practices, positive accounting theory should be able to prove not only the observations of economic realities, but also from a neoclassical point of view in order to explain accounting practices. The concept of positivism is a field of science which is based solely on physical facts with no metaphysical content. Positivism, a purely philosophical way of thinking, attempts to explain research on logical justifications. Positivism is concerned with information that can be obtained by observing data. An accounting theory based on logic will undoubtedly be influenced by positivism. Therefore, positive accounting theory research can always focus on logical explanations. In addition, positive accounting is also called “economy-based accounting theory” (Kacır, 2018: 917).

The Agency Theory explains managers' accounting policy choices and emphasizes why the accounting method available to managers is chosen. In this context, agency theory is also key to the development of PAT. In addition, three types of hypotheses are generally developed when conducting tests for accounting policy selection (investigating factors affecting accounting policy selection namely Bonus or Compensation Hypothesis, Debt Covenant Hypothesis and Size (Political Cost) Hypothesis. There will be more attention on the agency theory and the hypothesis of the PAT later on.

5.DISCRIMINATING BETWEEN POSITIVE AND NORMATIVE THEORIES

According to (Watts and Zimmerman, 1986: 8) “In economics, positive theory comes from the concept of the theory deployed in science traditionally to discriminate it from prescription or normative arguments. Accounting theories employ a logic, method, or rule for causation and verification. But these sometimes appear as practical results of a theory rather than a theory (Nalçın and Can, 2016: 166). Theorists have to be very careful in discriminating between positive and normative propositions. On the one hand, propositions related to positive theory are dealt with the situations in the real world. For example they are in the form of “If A then B” which is considered as refutable. On the other, prescriptive propositions is in the area of normative theories. In this case “Taking the set of circumstances C, D should be selected alternatively” which is not refutable.

There is an academic community that does not accept normative theories as a theory. Normative theories aiming at guiding practice do not actually address potential shortcomings and natural limitations (Malmi and

Granlund, 2009: 615). Far from empirical evidence (quantitative and / or qualitative), the prescriptive literature should not be classified as pragmatic science. (Jansen, 2018: 1488). A radical study about normative accounting by (Anthony M. Tinker et al. , 1982: 167-168) argues that the idea of positive accounting hypothesis is appeared to be an figment since research in accounting (or in any science) cannot be value-free or socially unbiased.

The reasons for the decrease in the normative theory’s credit have been questioned in many studies. Those who say that the theory is epistemologically lacking the basis are not quite right. It is necessary to search for this situation in its nature where it has disconnected with the practical world and has not been able to analyse it well (Singleton-Green, 2016: 137-138). The development of accounting principles focusing on accounting research and shifting to a more scientific methodology to explain and estimate the practice led to a shift from normative theory to positive theory (Coetsee, 2010: 4) (Jeanjean and Ramirez, 2009: 109) (Christenson; 1983: 1). The normative literature focuses on persuading managers to adopt an accounting tool or procedure that can be applied directly in practice, rather than providing systematic empirical research background to the development of accounting practices (Jansen, 2018: 1487).

It can be inferred from the above discussion that the PAT is one way or another value free and scientific, whereas the NAT was extremely value-laden and hence unscientific (Whittington, 2007: 392) Such an inference can cause objections. According to the normative theory approach, there is economic reality in accounting research, even if it is independent of accounting representation. Once the general laws of accounting nature have been established, it will be possible to improve accounting standards. In summary, it can be thought that normative theory in accounting discipline will help in solving the problems faced by managers in practice.(Jeanjean and Ramirez, 2009: 111). According to Michael C. Jensen (1976: 2), neither academics nor accounting practitioners would have made progress in finding answers to normative questions without positive accounting theories. Nevertheless, it is important to remember that there are normative implications of positive accounting theories. Therefore, it would be a wrong approach to eliminate normative accounting theories and to ignore them (Boland and Gordon, 1992: 146; Singleton-Green, 2016: 137-138). Although PAT theorists are careful with their practical approaches in accounting discipline, they are unaware that they are actually normative (Malmi and Granlund, 2009: 598).

6.MANAGERIAL IMPLICATIONS OF POSITIVE AND NORMATIVE THEORIES

Managerial implications focuses on the connection between the results and the actions (plan, organise, lead and control) taken by management and explains what these results (consequences or effects) mean. Otherwise stated, they compare the results with the standard of action and specifies which action should be performed in response. The implications should follow the objectives directly and summarize the answers to the questions investigated by providing evidence.

In order to draw a more clear view on managerial implications, there are two common core assumptions in manager’s behaviour that should be considered. First, Thornton observations in 1984 (cited in Mangos and Lewis, 1995) stated that managers are supposed to be rational economic benefit maximizers who take their own interests into account. On the other hand, it is assumed that managers behave in full competition market, which is associated with degree of efficiency in economic studies. It is based on the assumption that managers have opportunistic approaches to accounting policy selection. For example, in order to meet the demand to decrease earnings in the current period, managers have incentives to influence in reports by delaying recognition of earnings to a future period (Ozili and Outa, 2019: 185).

According to (Watts and Zimmerman, 1986: 2-3) external accounting reports including accounting procedures provide stakeholders with information that influences their decisions. So the corporate manager needs a theory to explain accounting procedures as they are the ones responsible of calculating numbers, explaining the reasons behind and choosing an audit firm. There are alternative methods that managers could choose from in order to maximize their wealth, described or prescribed by the theories. On the other hand managers want to be aware of how their decisions would be affected by the methods selected.

PAT's general interest is to examine the relationship between managers, owners and debtors who provide resources to an organization and how accounting will benefit them (Healy, 1985: 86). PAT suggests that accounting choices are made to minimize the company specific contracting cost including internal and external transaction cost, political cost and bankruptcy cost (Watts and Zimmerman, 1986: 134-137).

Normative theories in management accounting relate to specific practical problems and offer very specific recommendations on the measures to solve them. But, in management accounting, these normative theories are often a popular form of science because there is often little empirical evidence to support proposals in the prescription literature, and it is often difficult to predict the effects of such practical recommendations (Jansen, 2018: 1490). Therefore, in order to put these recommendations in practice, structures used, conditional releases and more about the causes underlying the relationship and applicability under claim are needed to improve, both empirically and conceptually (Malmi and Granlund, 2009: 609). The normative theory, which paradoxically distracts authors who attempt to integrate their practices into an abstract system, also helps to bring accounting theorists closer to other theory determinants (Jeanjean and Ramirez, 2009: 112). Achieving set goals can be difficult if they are uncertain or do not have detailed operational specifications (Inanga and Schneider, 2005: 231). The assumption that general theoretical accounting principles should be conformed implies that specific accounting practices can be handled in a normative context which can include empirical inductive approach. It is pointed out by the School of Rochester that accounting regulation can also be employed merely to describe behavior. Empirical efforts to meet their own needs cannot be sufficient to fully develop practice without the support of normative practice. (Whittington, 2007: 370-382)

The term “Accepted-Set” used by (Watts and Zimmerman, 1990: 136) refers to manager’s discretion on the set of accounting procedures. Agency Problem, bonus or compensation hypothesis, debt covenant hypothesis and size (political cost) hypothesis are the focus point of in many accounting choice studies, below a brief review of the procedures from the managerial consequences is explored.

6.1.Agency Problem

Agency Theory asserts that there are transaction and information costs which emerge from principal-agent relationships. If we assume a separation between the manager and the owner of a firm then the owner of the firm is reliant on the manager to provide them efficient information. Therefore, this assumption causes to emerge an information cost. It can be too costly if it is comprehensive or not much costly if it is not sufficient enough. In other words, an information asymmetry between insiders and outsiders brings Agency Theory into existence and therefore accounting choices and disclosures need to be investigated (Samaha and Khlif, 2016: 37).

It is the same problem addressed by Jensen and Meckling, 1976 (cited in Jones, Romano & Ratnatunga, 1995) , except that, because they include stock market price effects and fix wages, Jensen and MecMing are able to characterize the problem as the agent’s, not the principal’s. Alignment of preferences is costly because managers know more about decision-making and supply inputs (such as effort) that are not observed and cannot be inferred from output. The solution to the problem involves an optimal sharing rule (or incentive scheme) that trades-off the risk imposed on the manager (who is risk averse) against the provision of incentives to act as the principal wishes.

There are different perspectives in the literature that examine the usefulness of accounting information. In these researches, normative theory is taken into consideration in economic decision making, while the relationship between market figures and the usefulness of accounting figures and accounting information is discussed through agency theory with an encouraging perspective in positive theory. In these studies, where the link between the two focal points is neglected, the qualitative characteristics of decision-useful information about capital markets and agency conflicts are focused separately (Brigitte Eierle and Schultze, 2013: 6).

It is claimed that higher performance of the manager leads to higher expected payoff. This is why choosing accounting policies is important in terms of economic consequences. Efficient securities market and economic consequences can be reconciled by contract theory, with normative support from agency theory. According to the agency theory the reasons behind firms to sign employment and debt contracts depends on accounting information. This does not necessarily lead to managerial concern about accounting policies conflict securities market efficiency. Furthermore, Accounting policies may well be intervened by the manager, in which the decision usefulness of financial statements would be improved. As a result, the relationship between managers and investors is a game (Scott, 2015: 389). The studies conducted to explain manager’s incentives to choice accounting policy does not provide the overall motivation of the manager since these studies mainly focus on a single accounting choice at a time (Waweru et al. , 2011: 147).

Economists who analyse a social phenomenon eventually reach normative inferences. For instance, the information economy deals with information asymmetry and reaches the idea that mechanisms should be devised to reduce this problem. In agency theory, this works as follows; corporate governance mechanisms should be designed and implemented to reduce the agency problem caused by the separation of ownership from control in large firms (Kabir, 2015: 1).

Positive accounting theories are organized through three main hypothesis; bonus plan hypothesis, the debt covenant hypothesis and the political cost hypothesis. In the following section these hypothesis will be examined from the managerial perspective.

6.2.Bonus or Compensation Hypothesis

One of the key hypotheses used in PAT literature is the bonus plan hypothesis. This hypothesis is emerged from the relationship between the owner and the manager of the firm. As we mentioned earlier, PAT assumes that all individuals act for the best of their interests. In such a situation, the behaviour of managers may not be in the same direction as the best interest of the owners. For example, stakeholders demand information in their best interests in order to make upcoming decisions. Therefore, the information must be supplied in a sufficient way. On the other hand, the information supplied sufficiently might be too costly for manager and that may cause a decline when reporting the interest of the firm in the annual returns. This conflict noted earlier as an agency problem. At this stage, remuneration plays an important role for managers in their behaviours. Managers rewarded on a fixed basis never want to take great risks for any potential gains and that may cause a loss for the owner and shareholders (Scott, 2006: 328). Also, the manager rewarded on a fixed basis would have limited incentives to adopt strategies which can increase the firm's value.

According to the PAT, the incentives to manage earnings is determined by the existence of explicit contracts such as debt covenant violation, political scrutiny and bonus plan (Ozili and Outa, 2019: 174).

(Watts and Zimmerman, 1978: 114) defined management compensation very broadly; including wages, bonuses, stock options, and non-pecuniary income, perquisites. The literature has focused almost exclusively on bonuses, which are based on accounting income and thus appear to be related directly to accounting choices that affect income. The results were mixed Zmijewski and Hagerman in 1981 (cited in Jones et al. , 1995: 315), in a search for the existence of an overall income strategy consisting of simultaneous choices revealed that a bonus plan is not always significant in accounting choices. Bowen et al. in 1981 (cited in Jones, Romano & Ratnatunga, 1995) investigated the significance of a bonus plan in explaining management's choice of expensing or capitalizing interest during the construction period of fixed assets. They found that fifty-one percent of the firms in their sample capitalized interest, and concluded that companies without a bonus plan are not also less likely to capitalize interest rates than others. In determining whether a company had a bonus plan or not, they interpreted the absence of a clear statement that a plan existed to mean that a plan did not exist. Abdel-Khalik in 1985 (cited in Jones, Romano & Ratnatunga, 1995) conducted an examination of the effects of the change from FIFO to LIFO on managerial compensation. He found that managers' compensation did not decline for the firms that switched from FIFO to LIFO. He interpreted this finding to mean that either terms of the bonus plan were modified, or that the bonus plan continued to be based on FIFO income.

Management's compensation effects have been found significant in explaining management's choice of accounting procedures. The studies testing this effect have focused on the increase in management's compensation due to any increase in reported accounting income, assuming that virtually all firms have bonus plans that are tied to reported accounting earnings, explicitly or implicitly. However, managers are hypothesized to view disclosures as signaling devices and to believe that investors will interpret cash flow information in the same manner that they interpret cash flow information in the same manner that they interpret accounting income information. Favorable information has been show to raise share prices is part of the bonus hypothesis of (Watts and Zimmerman, 1978: 131). Manager's compensation has not been investigated on the effect of stock price extensively, but preliminary results are positive. A direct measure (number of stock options owned) of the effect on manager's compensation due to an increase in share price will be incorporated into the model.

Normative accounting theory also refers to earnings management. It has been traditionally pointed out that the measurement should be objective but it is a difficult task. Objectivity and hardness have been emphasized in order to ensure that managers display income reliably in accounting reports. In some studies, it is stated that the accounts should not be artificially modified in order to show a smooth income flow (Kabir, 2015: 26).

6.3.Debt Covenant Hypothesis

Debt contracts are restrictive and are designed to keep wealth transfers between debt and equity holders at a certain level (Watts and Zimmerman, 1978: 114). Some studies suggest that these restrictions affect the choice of accounting policy of management. For example, significant linkages have been found between the leverage ratio variable and the choice of accounting policy.

Healy and Palepu in 1990 (cited in Jones et al. , 1995: 324) presented evidence that the debt covenants influenced management's behavior, but not as predicted by positive accounting theory. They conducted an investigation of the effectiveness of accounting-based debt constraints and concluded that such constraints are significant influences on management's behavioral response is to reduce the level of dividends rather than to increase accounting income through discretionary accounting changes. Debt covenant constraints have been found significant in explaining management's choice of accounting procedures that affect earnings, assets, and the earnings available for dividends. The proposed study is an examination of adoption date of SFAS No. 95, which does not affect earnings, assets or the earnings available for dividends. However, cash flows are hypothesized to act as signals that influence investors' perceptions to act as signals that influence investors' perceptions of firm's risk class.

In summary, managers are affected by accounting policies because their ability to avoid debt covenant violations and their compensation are bounded to these policies. It means that when accounting standards change, they have economic consequences under compensation and debt contracts (Scott, 2015: 358).

6.4.Size (Political Cost) Hypothesis

According to (Watts and Zimmerman, 1978: 127), some large firms tend to avoid the attention of politicians and regulators by choosing revenue-reducing accounting methods. This is because they are open to excessive profit taxes and political costs arising from anti-trust regulations. This hypothesis has led to the discussion of size in many studies. In this context some research studies are representative of those studies which hypothesized size to be a proxy for political costs and found the proxy to be significant (Jones et al. , 1995: 38). In an enterprise with high political costs, it is thought that managers will turn to current income reduction accounting methods (Waweru et al. , 2011: 146).

The background of this hypothesis is the cost of informing the concerned parties whether their accounting profits really show monopoly profit, and contracting with others in the political procedure to enforce laws and regulations that rise their well-being (Sinha, 2008: 7). Increasing compliance with IFRS as a limited choice of accounting policy can be an intention for businesses that are exposed to high political costs (Samaha and Khlif, 2016: 38). The political cost hypothesis points out that it will not be possible to explain all the decisions (even accounting) taken by an enterprise for economic reasons (Michael, 2007: 10).

The reason for the relationship between these constructs should be kept simple and understandable. Expected benefits based on the assumption that you get what you measure are considered as part of management control. Moreover, when you establish the right system, managers should be able to have the right incentives to act in accordance with the interests of the shareholders. At this point, bonuses and career development should be considered in connection with the achievement of such goals (Malmi and Granlund, 2009: 606).

CONCLUSION

Zimmerman presents many interesting and controversial ideas that deserve careful consideration and discussion. Management accounting is at an early stage in the development of the literature at this point and does not produce an integrated set of theories and empirical results. In addition, other empirical accounting studies have not yet fully completed their evolution (Ittner and Larcker, 2010: 791-792). Practitioners often have a tendency to appreciate effective managerial solutions in which the results reflecting practical value are simple, easy to use and have a positive cost-benefit ratio (Lukka and Granlund, 2002: 178). When making an accounting policy selection, for example, debt covenant and political costs variables can be adversely affected. For this reason, it is assumed that managers will pay attention to the method that gives the best results when choosing accounting.

The theories including positive and normative aspects are likely to contribute to the managers with practical issues by demonstrating practical approaches that can explain the choice of accounting and making predictions for the future. (Malmi and Granlund, 2009: 601). Regardless of whether the theoretical rigor or practical relevance is more or less balanced, some other approaches mentioning the nexus between both practical and theoretical knowledge exist (e.g. interventionist research, conditional normative accounting methodology) (Jansen, 2018; Mattessich, 1995). These theories and other derivatives undoubtedly contribute to the diversity of accounting research approaches as well as practical aspects of management accounting.

One function of accounting theories is to be a guide for the practitioners of that discipline to make decisions. In the accounting literature there are some justifications in positive theory that has used by previous researchers who were quite normative. Although there are extreme oppositions between positive and normative accounting theories, in my opinion it is evident that methodology does not have to be either prescriptive or normative. Furthermore, manager's behaviors do not have to be biased towards prescriptive or normative accounting theory. Although, positive and normative accounting theories could not explain all the observations that managers have, both accounting theories are important for managers to make felicitous decisions. There could be some limitations in this report as a result of lack of articles related to normative accounting theories. My findings are also relevant to the existing researchers in terms of the criticisms.

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